June 30, 1998

D.T.E. 97-120-1

Petition of Western Massachusetts Electric Company pursuant to General Laws Chapter 164, §§ 76 and 94, and 220 C.M.R. §§ 1.00 et seq., for review of its electric industry restructuring proposal.

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INTERLOCUTORY ORDER ON RESTRUCTURING PLAN AMENDMENTS

I. INTRODUCTION

Western Massachusetts Electric Company ("WMECo" or "Company") has submitted proposed amendments ("Proposed Amendments") to its restructuring plan ("Plan") to the Department of Telecommunications and Energy ("Department") for review. The Proposed Amendments address the (1) divestiture of non-nuclear generation facilities, (2) valuation and divestiture of nuclear facilities, (3) standard offer service procurement and the backstop obligation, and (4) an additional 2.4 percent rate reduction. The Company has requested eight interim rulings from the Department related to the Proposed Amendments.

II. PROCEDURAL HISTORY

On December 31, 1997, WMECo submitted the Plan to the Department for review. On February 19, 1998, the Department issued an Initial Order, subject to further review and reconciliation, approving the Company's Plan.[1] Western Massachusetts Electric Company, D.T.E. 97-120 (1998). On May 7, 1998, the Department conducted a prehearing conference to establish a procedure for the submission of the Proposed Amendments and comments from interested parties. On May 15, 1998, the Company submitted the Proposed Amendments to the Plan, and on May 22, 1998, the Company supplemented the Amendments with requests for interim rulings related to the Proposed Amendments. On June 1, 1998, the Department received comments on the Proposed Amendments from the Office of the Attorney General ("Attorney General"), the Division of Energy Resources ("DOER"), and the Western Massachusetts Industrial Customers Group ("Industrial Customers").

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[1] Tariffs, in compliance with the Department's Initial Order were approved on March 3, 1998

III. STANDARD OF REVIEW

The Legislature has vested broad authority in the Department to regulate the ownership and operation of electric utilities in the Commonwealth. See, e.g., G.L. c 25, §§ 5, 9, 18, 19, and 20; c. 111, §§ 5K and 142N; and c. 164, §§ 1 through 33, 69G through 69R, 71 through 75, and 76 et seq. This authority was most recently revised and augmented by the Electric Industry Restructuring Act, Chapter 164 of the Acts of 1997 ("Act"). Among other things, the Act authorizes and directs each electric company organized under the provisions of [G.L. c.164] to file with the Department a detailed plan for restructuring its operations to allow for the introduction of retail competition in generation supply in accordance with the provisions of this chapter." St. 1997, c. 164, § 193 (G.L. c. 164, § 1A(a)). The Act directs that "the Department shall review each plan and make an express finding to determine whether such plan is consistent or substantially complies with the provisions of this chapter." Id. Pursuant to this statutory authority, the Department will review an electric company's restructuring plan to determine whether such plan is consistent with or substantially complies with the applicable provisions of the Act. With respect to matters not explicitly addressed by the Act, as noted above, the Department retains broad authority to address such matters. See, e.g., G.L. c 25, §§ 5, 9, 18, 19, and 20; c. 111, §§ 5K and 142N; and c. 164, §§ 1 through 33, 69G through 69R, 71 through 75, and 76 et seq.

IV. PROPOSED AMENDMENTS

A. Non-nuclear Divestiture Amendment

1. Company’s Proposal

The Company’s Plan included a proposal to divest all of its non-nuclear facilities as early

as June 30, 1998 (Plan at 41, 43). In its Proposed Amendments, the Company plans to postpone the divestiture of the Northfield Mountain Pumped Storage facility and the related hydroelectric facilities, Turner Falls and Cabot, ("Northfield and Related Facilities") until sometime in 1999 so that WMECo's 19 percent minority interest in Northfield can be sold in conjunction with the majority interest held by Connecticut Light & Power Company ("CL&P"), a WMECo affiliate (Proposed Amendments at 2).[2] Prior to divestiture, WMECo proposes to treat Northfield and Related Facilities as a purchased power agreement ("PPA") for the purposes of transition charge (id.).[3] WMECo states that if transition cost recovery is jeopardized by its sale date proposal, it would sell Northfield and Related Facilities separately from CL&P, despite WMECo's expectation of a lower level of proceeds (id.).

a. Company's First Request

WMECo requests an interim ruling that it is within the discretion of the Department to approve the Company's proposal, including transition cost recovery, by finding that it is in substantial compliance with the Act (id.). The Company anticipates that a final ruling on the Company's proposal, including its divestiture plans for Northfield and Related Facilities, would occur after evidentiary hearings on its Plan (id.).

i. Comments

With respect to the sale date of Northfield and Related Facilities, the Industrial Customers state that such sales must be completed by August 1, 1999 to be in compliance with the Act

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[2] CL&P is required to divest its ownership share in 1999 by the Connecticut restructuring law (id.).

[3] The net revenues from the PPA will be used to offset the transition costs (id.).

(Industrial Customers Comments at 2). In contrast, DOER notes that although the Act imposes an August 1, 1999 deadline for non-nuclear divestiture, the Department has the discretion to determine "substantial compliance" with this provision (DOER Comments at 4). However, DOER objects to the Company's proposal to treat Northfield and Related Facilities as a PPA. DOER contends that future operating costs, such as those encompassed by this PPA treatment, do not qualify as transition costs under the Act. DOER states that it will present a direct case on this point during evidentiary hearings, and will it suggest alternatives to the Company's proposal (DOER Comments at 6).

ii. Analysis and Findings

The Department has the authority to determine whether a restructuring plan is consistent or substantially complies with the provisions of Chapter 164 of the Act. G.L. c. 164, § 1A(a). The use of "substantially complies" indicates that the Legislature has given the Department a measure of discretion to effect the important public purposes of the Act. The sale of WMECo's minority ownership of Northfield and Related Facilities, in conjunction with CL&P's majority ownership sale, may maximize the proceeds, which would produce ratepayer benefits in the form of greater stranded cost mitigation.

With respect to DOER's comment regarding the treatment of Northfield and Related Facilities as a PPA, the Department will investigate during evidentiary hearings whether the net revenue credit from the Company's proposal represents mitigation of transition costs. Accordingly, it is within the Department's discretion to approve the Company's proposal, including transition cost recovery, as in substantial compliance with the Act.

b. Company's Second Request

WMECo requests an interim ruling finding that if the Northfield and Related Facilities proposal is approved, such approval will satisfy the obligation to divest and mitigate stranded costs as a condition to securitization (May 22, 1998 Letter at 2).

i. Comments

The Attorney General contends that it is not within the discretion of the Department to allow securitization prior to sale of the Northfield and Related Facilities. The Attorney General claims that the Act prohibits securitization since "an electric company which fails to commence and complete the divestiture of its non-nuclear generation assets shall not be eligible to benefit from the securitization provisions and the issuance of rate reduction bonds" and because the Act clearly prohibits securitization unless and until a company has established that it has fully mitigated its transition costs (Attorney General Comments at 4).

DOER states that the Act allows the Department discretion to permit a company to obtain securitization even if divestiture has not been completed (DOER Comments at 4). DOER notes that an electric company which fails to commence and complete the divestiture of its non-nuclear generation assets shall not be eligible to benefit from the securitization provisions and the issuance of electric rate reduction bonds, subject to determination by the Department (id., citing G.L. c. 164, § 1G(d)(3)).

ii. Analysis and Findings

The Act provides that an electric company's plan to commence and complete divestiture is "subject to determination by the Department." St. 1997, c. 164 § 193 (G.L. c. 164, § 1G(d)(3)). The phrase "subject to determination by the Department" grants the Department the discretion to

approve securitization associated with a divestiture plan that is consistent with the Act, even if the divestiture will not be completed prior to securitization. Therefore, the Department has the discretion to permit a company to obtain securitization prior to the completion of divestiture.

With respect to the Attorney General's second point regarding full mitigation, the Department notes that proof of full mitigation is subject to the satisfaction of the Department: "Securitization shall not be made available... unless the electric company proves to the satisfaction of the department ... it has fully mitigated... its related transition costs, including... divestiture of its non-nuclear generation facilities." St. 1997, c. 164, § 193 (G.L. c. 164, § 1G(d)(4)). Therefore, the Department has the discretion to allow securitization in the case of a sale of the Northfield and Related Facilities subsequent to August 1, 1999. Accordingly, the Department finds that the Company's Northfield and Related Facilities divestiture proposal, if approved, would satisfy the obligation to divest and mitigate stranded costs as a condition to securitization.

c. Company’s Third Request

WMECo requests that its proposed plan for Generating Asset Portfolio Divestiture (“Divestiture Plan”), as set forth in Section 3 of the Proposed Amendments, be approved (May 22 Letter at 2-3). The Company states that, subsequent to the implementation of the Divestiture Plan, it will petition the Department for approval of the results of the Divestiture Plan. At that time, according to WMECo, the Department could determine whether the evaluation of bids was fair and whether the sale prices maximized the value of the divested facilities (id.).

i. Comments

The Attorney General and DOER state that the Department should reject the Company's request for an approval of its Divestiture Plan. Both parties note that the Divestiture Plan

involves complex issues that must follow the Department's established procedures for investigating such matters, e.g., pre-filed testimony, discovery, and evidentiary hearings, before its merits can be determined (Attorney General Comments at 5; DOER Comments at 6). DOER notes that, in all other electric companies' restructuring proceedings, the Department has not investigated proposed divestiture plans until such time as the results of the plan are submitted for Department review (DOER Comments at 6-7). DOER asserts that WMECo's Divestiture Plan differs from those of other electric companies because WMECo affiliates intend to participate. DOER contends that, because of the participation by affiliates, a "post-bid review of the bid design is more likely than not to lead to re-bid in this case" (id.). Therefore, DOER contends, that after the Department's procedures have been followed, it would be appropriate for the Department to issue an order regarding the Company's Divestiture Plan prior to implementation of that plan (id.).

ii. Analysis and Findings

As stated by the Attorney General and DOER, the Divestiture Plan involves complex issues that require full investigation. Approval of the Divestiture Plan prior to the development of an evidentiary record would be inconsistent with the Department's well-established investigatory procedure. In addition, the Company's Divestiture Plan includes the provision that the Northfield and Related Facilities would not be sold concurrent with the Company's other non-nuclear facilities. Thus, approval of the Divestiture Plan would include the approval of the proposal regarding the Northfield and Related Facilities. Such an approval would be inconsistent with the Company's statement, on page 1 of its May 22 Letter, that it anticipates that the Department's final ruling on its divestiture plan for Northfield and Related Facilities "would occur after

evidentiary hearings" on its restructuring plan. Therefore, the Department rejects the Company's request for approval of its Divestiture Plan.

With respect to DOER's recommendation that the Department investigate the Company's Divestiture Plan prior to implementation, the Department concludes that, consistent with our treatment of proposed divestiture plans in other electric companies' restructuring proceedings, the appropriate time to review the Company's Divestiture Plan is when the results are known and submitted for Department review. Cambridge Electric Company, Commonwealth Electric Company, Canal Electric Company, D.P.U./D.T.E 97-111, at 64 (1998); Boston Edison Company, D.P.U./D.T.E 96-23, at 41 n.25 (1998); Eastern Edison Company, D.P.U./D.T.E 96-24, at 20-21 (1997). Therefore, the Department will not review the Company's Divestiture Plan as part of this proceeding. However, the Department emphasizes that, at the time that the Company seeks approval of the results of its divestiture, the Company will bear the burden of demonstrating that all respondents to the divestiture solicitation were treated equally. Given the participation by affiliates, the Department will scrutinize the transaction particularly carefully to ensure that implementation of the Company's Divestiture Plan results in the maximum mitigation of the Company's transition costs.

B. Nuclear Divestiture Amendment

1. Company’s Proposal

In the Company’s Plan, WMECo offered to conduct a valuation of its Millstone nuclear facilities by December 31, 2009, with nuclear transition costs to be offset by a revenue-sharing performance-based rates (“PBR”) mechanism (Plan at 37, 39). No divestiture had been proposed. In its Proposed Amendments, the Company proposes to divest these nuclear facilities no later than

December 31, 2003, selling its minority interests in conjunction with the majority owner, CL&P (Proposed Amendments at 4).[4] Rather than wait until 2003 to securitize, the Company proposes securitization of nuclear facility transition costs in the near term, at a level limited to 90 percent of net book value of such facilities (id.).

a. Company's Fourth Request

WMECo requests an interim ruling finding that it is within the discretion of the Department to approve the Company's proposal (May 22, 1998 Letter at 2). The Company anticipates that a final ruling on its nuclear divestiture proposal would occur following evidentiary hearings on its Plan (id.).

i. Comments

The Attorney General claims that the Department should not make a ruling because no factual record has been developed on the Company's proposal (Attorney General Comments at 5). DOER asserts that the Department does not have the discretion to approve the Company's nuclear divestiture proposal because that proposal is not consistent with the Act. DOER contends that the Company's approach, i.e., collection of the unmitigated net book value in the transition charge, is expressly prohibited by the Act, G.L. c. 164, § 1G(a)(1)(b) (DOER Comments at 12). DOER argues that costs which can be recovered from the market cannot be included as transition costs (id.). Therefore, DOER concludes that WMECo is required to value its nuclear facilities and recover through the transition charge only the above-market portion of net book value (id. at 14).

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[4] WMECo owns 19 percent of Millstone 1 and 2, respectively, and 12 percent of Millstone 3.

ii. Analysis and Findings

The Act is silent with respect to electric company divestiture of nuclear facilities. On that basis this matter falls within the discretion of the Department. However, under the Act, divestiture of non-nuclear facilities qualifies as mitigation. St. 1997, c. 164, § 193 (G.L. c. 164, § 1G(d)(1)). Under the Company's proposal, divestiture will take place by 2003 and, in the meantime, ratepayers will receive benefits from the Company's revenue-sharing PBR mechanism, a mechanism that also qualifies as mitigation under the Act.[5] St. 1997, c. 164, § 189 (G.L. c. 164, § 1).

The Department notes that the Act also provides the Department with discretion in terms of nuclear asset cost recovery because, under the Act, transition costs include "*department-authorized* recovery for nuclear entitlements..." (emphasis added). St. 1997 c. 164, § 193 (G.L. c. 164, § 1G(b)(1)). The Department acknowledges that the Act does require mitigation as a condition to the recovery of transition costs. Id. However, the Company's commitment to divest and its PBR mechanism provide grounds for determining that the Company has satisfied mitigation requirements conditional to recovery of nuclear facility transition costs. Accordingly, the Department finds that it is within our discretion to approve the Company's nuclear divestiture proposal. However, a finding now that it is within our discretion to approve this proposal does not constitute an approval of this proposal. A final ruling on the Company's proposal will be made following evidentiary hearings.

b. Company's Fifth Request

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[5] The Department also recognizes that WMECo's proposal replicates the method accepted by the Department for Boston Edison Company's Pilgrim nuclear facility. Boston Edison Company, D.P.U./D.T.E 96-23, at 42, 45 (1998).

WMECo seeks an interim ruling finding that the Department has the discretion to approve the Company's plan to limit the securitizable amount of nuclear plant investment to 90 percent of book value, and finding that, along with the PBR mechanism for the nuclear facilities, these steps satisfy the obligation to mitigate costs prior to their securitization (May 22, 1998 Letter at 3).

i. Comments

The Attorney General contends that the Department has no discretion to approve securitization of costs until the Company has proven that it has fully mitigated its transition costs (Attorney General Comments at 4-5) and that such costs have been found to be both "prudent" and "uneconomic as a result of the creation of a competitive generation market." DOER notes that the Act grants the Department a measure of discretion, in that full mitigation is a prerequisite to securitization, and the Department determines what constitutes full mitigation (DOER Comments at 15). However, DOER suggests that the Department's discretion is limited, in that the Act allows securitization of transition costs only, i.e., embedded costs remaining after mitigation and a credit for residual value (id.).

ii. Analysis and Findings

A restructuring plan is not the appropriate forum for evaluating a specific limit on securitization, as such a matter would be properly investigated in a securitization financing proceeding. Therefore, at this time, the Department rejects the Company's request that the Department find it is within its discretion in this proceeding to approve a limit on the amount of nuclear assets that can be securitized, and to determine that, with the PBR mechanism, the Company's proposal would satisfy the obligation to mitigate these costs prior to securitization.

C. Provision of Standard Offer Service and Backstop Obligation Amendment

1. Company's Proposal

The Company's Plan included the provision that the wholesale price that the Company would pay for Standard Offer Service supply would be capped at specified prices for each year that Standard Offer Service is available (Plan at 26, 29-30). The Company stated that it intended to identify Standard Offer Service suppliers through a competitive solicitation in which the winning bidder would be the supplier or suppliers that offered the highest discount to the specified annual price caps (id.).[6] The Company stated that, if the solicitation did not result in winning bids sufficient to meet the Company's projected Standard Offer Service requirements, the purchasers of the Company's divested generation would be required to provide Standard Offer Service supply (i.e., the backstop obligation) at the specified price cap levels (id. at 29). The Plan also included a proposal for the treatment of any under- or over-recoveries of Standard Offer and Default Service costs (id. at 30-31).[7] To the extent that, in any year, the wholesale prices for Standard Offer and Default Service exceeded the retail prices, the Company proposed to defer the collection of the resulting under-recovery until such time that the amount could be recovered through the variable component of the transition charge in accordance with any applicable inflation cap (id.). To the extent that, in any year, the wholesale prices for Standard Offer and Default Service were less than the retail prices, the Company proposed to credit the over-recovery to all of its retail delivery customers during the following year (id.).

In its Proposed Amendments, the Company seeks to eliminate the Standard Offer Service

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6 The Plan did not include a copy of the Company's proposed Request for Proposal.

7 The Company stated that the price and terms for Default Service would be identical to those for Standard Offer Service, until the date of divestiture (id. at 33).

supply price caps and the requirement that purchasers of the Company's divested generation assume the backstop obligation (Amendment at 3-4). Instead, the Company proposes to issue a Request for Proposals ("RFP") in which the winning bid or bids would determine the wholesale price for Standard Offer Service supply (id.). The Proposed Amendments include a draft of the Company's proposed RFP for Standard Offer Service supply, in which bidders would be provided multiple options for developing their proposals (id., Section 2). Finally, the Company proposes to defer and securitize any under-recovery of Standard Offer and Default Service costs (id. at 3-4).

a. Company's Sixth Request

WMECo requests that the Department approve the Company's amended process for procuring Standard Offer and Default Service supply. The Company adds that, subsequent to the selection of a winning party or parties to the solicitation, it would petition the Department for approval of the results of the procedure set forth in the solicitation plan, i.e., that the evaluation of the bidders had been fair and that the process optimized the wholesale price of Standard Offer and Default Service.

i. Comments

The Attorney General and DOER assert that the Department should reject the Company's request for approval of its proposed plan for the procurement of Standard Offer and Default Service supply because the procurement plan involves complex issues that must be investigated before a determination can be made (Attorney General Comments at 5; DOER Comments at 8).

ii. Analysis and Findings

The Company is requesting approval of its proposed Standard Offer and Default Service

procurement plan, including its proposal to eliminate the wholesale price cap, before the Department or any party has had the opportunity to fully examine the details included in the plan. The Department concludes that such an approval would be inappropriate, particularly because, as stated by the Attorney General and DOER, the plan involves complex issues that merit investigation. Therefore, the Department rejects the Company's request that its proposed Standard Offer and Default Service procurement plan be approved at this time. The Department will investigate the price for Standard Offer Service during this proceeding.

b. Company's Seventh Request

The Company requests that the Department approve the deferral of the revenue shortfalls incurred due to the provision of Standard Offer and Default Service, and approve the transition cost recovery and securitization of such deferrals.

i. Comments

The Attorney General asserts that it is "plain" that it is not within the Department's discretion to approve securitization of costs of any generation-related regulatory assets that were not existing at the time of the enactment of the Act (Attorney General Comments at 5). Therefore, the Attorney General states that the Company's request for Department approval to securitize the underrecovered Standard Offer Service costs should be rejected.

DOER argues that the Company's proposal to securitize must be denied because (1) the underrecovery of Standard Offer Service costs does not fit any of the transition cost categories specified in the Act; (2) under the Act, only transition costs may be securitized; and (3) the Act does not give the Department the discretion to create new categories of transition costs (DOER Comments at 8-11). Conversely, DOER states that neither the Act nor Department precedent

precludes the Department from allowing the Company to defer the costs associated with the Standard Offer price differential (id.).

ii. Analysis and Findings

With respect to the Company's proposal to defer the recovery of the Standard Offer and Default Service revenue shortfalls, the Department notes that we have approved deferral treatment of Standard Offer and Default Service revenue shortfalls under particular circumstances in the restructuring proceedings of other electric companies. See Cambridge Electric Light Company, Commonwealth Electric Light Company, and Canal Electric Company, D.P.U./D.T.E. 97-111 at 35. Moreover, the Act contemplates deferrals as a mechanism to address the difference between the price charged to customers for Standard Offer Service and the price to procure Standard Offer Service supplies. St. 1997, c. 164, § 308. See Boston Edison Company, D.P.U./D.T.E 96-23, at 32 n.18 (1998). Therefore, the Department concludes that it is within our discretion to consider the Company's proposal in this proceeding.

With regard to the Company's proposal to securitize these revenue shortfalls, the Department concludes that we cannot determine whether it is within our discretion to allow such securitization without further investigation. The ability of the Company to securitize the Standard Offer and Default Service revenue shortfalls will depend on, among other things, whether the Department, after investigation, finds that these costs qualify as transition costs. The Department will conduct this investigation during the course of this proceeding.

D. Additional Rate Reduction Amendment

1. Company's Proposal

The Company's Plan provided for a 10 percent rate reduction from the rates that, but for a settlement credit which expired on February 28, 1998, would otherwise have been in effect in August of 1997 (Plan at 3). In the Proposed Amendments, the Company proposes to reduce rates a further 2.4 percent, coupled with a deferral of the additional rate reduction (Amendment at 5). The Company proposes that the deferred amounts be recovered as transition costs and securitized (id.).

a. Company's Eighth Request

WMECo has requested an interim ruling finding that the Department has the discretion to grant the Company's request to defer for later collection, and to allow securitization of, the amount associated with the additional 2.4 percent reduction.

i. Comments

With respect to the Company's proposal that the deferred amounts be securitized, the Attorney General argues that the recovery of such costs as transition costs is inconsistent with the Act (Attorney General at 2). The Industrial Customers contend that the additional reduction should have been provided by the Plan and oppose deferral of the additional reduction (Industrial Customers Comments at 3). DOER states that costs associated with the additional rate reductions do not fit within the permitted categories for transition cost recovery, and the Department does not have the discretion to create new categories (DOER Comments at 16). Further, DOER states that, because these costs do not qualify as transition costs, they can not be securitized (id.).

ii. Analysis and Findings

With respect to the Company's request for an interim ruling finding that the Department has the discretion to defer for later collection the amounts associated with the additional rate reduction, the Department notes that the deferral mechanism has been employed in other aspects of electric companies' restructuring plan. See Section C.1.b.ii, supra. The Act has conferred upon the Department some degree of flexibility for the purpose of achieving the required rate reduction. See e.g., G.L. c. 164, § 1G(c)(3), (4). Therefore, it is within the Department's discretion to consider a deferral of the amounts associated with the additional rate reduction.

The determination of whether the Department can allow securitization of the amount associated with the additional rate reduction cannot be made without further investigation. Securitization of the amount associated with the additional rate reduction would depend on whether the Department, after investigation, finds that these amounts qualify as transition costs. The Department will conduct this investigation during the course of the proceeding.

V. ORDER

Accordingly, after due notice and consideration, it is

ORDERED: That the Western Massachusetts Electric Company may propose amendments to its Restructuring Plan consistent with the directives of the Department contained herein.

By Order of the Department,

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Janet Gail Besser, Chair

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James Connelly, Commissioner

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W. Robert Keating, Commissioner

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Paul B. Vasington, Commissioner